More about Whether Life Estates Are Eligible for a Step-up in Basis in 2010

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I had asked for feedback on elder law listservs about my position that a life estate may be eligible for a step-up in basis in 2010. One disagreeing commentator wrote:

"The basis step up is limited to property that passes by reason of death. When a life estate is established the legal ownership of the property is separated into 2 fee interests, the life estate and the remainder. Each can be leased, mortgaged and are subject to foreclosure. Therefore, the remainder interest did not pass by reason of death. The passing of title took place when the life estate was retained. All that happened is the remainder interest VESTED upon death. As a result, no step up."

These points are well-taken. Our disagreement is zeroed in on the attributes of a life estate. My point remains that the life tenant has exclusive possession during lifetime, and the home that is the subject of the reserved life estate remains completely controlled by the life tenant. Use and possession by the remainderpersons is prevented until the life tenant's death. While theoretical separation of the interests may occur, no actual separation occurs, and the theoretical separation does not give a present, usable benefit to the remainderpersons, as the life tenant controls whether the actual separation can occur by sale or partition. The remainderpersons don't have anything real until the death occurs, and they receive their usable interest without consideration only as a result of the life tenant's death.

Section 1022(e)(1-3) covers bequests, devises, inheritances, revocable trusts and many irrevocable trusts, so there isn't much left to be covered by Section 1022(e)(4), which includes "Any other property passing from the decedent by reason of death to the extent that such property passed without consideration." What type of ownership interest would Section 1022(e)(4) be covering that isn't already covered by (1), (2) and (3)? If life estates were meant to be excluded, perhaps Section 1022(e)(4) would only cover assets held jointly or subject to a transfer-on-death designation, but if Congress was intending to create such strict limitations, those interests could have been specifically mentioned. The language of Section 1022(e)(4) seems to indicate that Congress intended it to be a broad category.

I did state that my position is not a slam dunk, but I'm still not buying that life estates were intended to be excluded from the possibility of a step-up in basis.